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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1932.

No. 128

WABASH VALLEY ELECTRIC COMPANY,
Appellant,

vs.

RALPH M. YOUNG, (substituted for Frank T. Singleton) *et als.*,
Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF INDIANA.

REPLY BRIEF FOR APPELLANT.

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REPLY BRIEF FOR APPELLANT.

Appellees' statement mingles conclusions and arguments with the facts in such a manner as to make them inseparable. We shall reply to the ones we consider material.

Rate making is a legislative function. But neither the Indiana statutes nor the order of the commission fixing electrical rates for Martinsville binds the court to Martinsville as a rate base area. Appellees fail to distinguish between the legislative nature of the proceedings before the commission and the judicial nature of a suit in court charging confiscation. *Prentis* v. *Atlantic Coast Line,* 211 U. S. 210, 226-227. There is no issue in this judicial proceeding as to the area for which the commission may prescribe rates by any particular order. The issue here, where the charge is confiscation, is whether the electrical rates fixed by the commission for Martinsville are to be tested as to their constitutionality by their effect on the Martinsville local property and a segregated portion of the power system property allocated to the Martinsville service; or are to be tested in connection with the rates in effect in the other portion of the area served by appellant's system by the relation which the net revenue from all of appellant's electrical service bears to the value of all of appellant's property used and useful as a single interconnected electrical operating unit in rendering such service, as appellant has claimed from the outset before the commission (R. 20 and 21), the master (R. 110) and the district court (R. 146).

The caption, "appellant's property not single physical and economic system" (Bf. p. 3) is not supported by the statement which follows it. From that statement it

is clear, rather, that appellant's property is exactly the single physical and economic system which appellant claims. Indeed, appellees themselves refer to it as an "integrated parcel" of a larger power system serving many communities in Indiana. They do not dispute the fact that appellant's property is physically interconnected throughout. They do not deny that its parts are economically interdependent. They point out merely, that it is affiliated with and operated in conjunction with a number of other similar interconnected electrical systems. We have not denied this or minimized it. On the contrary, we have emphasized it, for it is the key to much that we have contended for in our original brief. This court has no basis in the evidence, or in anything contained in appellees' brief, for considering appellant's property as anything other than a single physical and economic unit.

Appellees assert that this "case concerns only rates fixed for service in Martinsville" (Bf. p. 4). True, the petition before the commission was by seventeen residents of that city and the only rates mentioned were rates in Martinsville; but it is almost naive for appellees to assert, upon the basis of this circumstance, that the constitutional question here presented is limited accordingly. As a matter of local procedure, it was competent for ten or more individuals to invoke the jurisdiction of the Public Service Commission by complaining of any rate or rates which directly concerned them. It did not follow that the commission could act upon their complaint without regard to the constitutional rights of appellant. This court has pointed out that no power resides in a state to accomplish, through the device of relying upon its local forms, that which the constitution of the United States forbids. (*Brooks-Scanlon Company* v. *Railroad Commission*, 251 U. S. 396, 400). Appellees' further statement,

"No effort was made (before the commission) by either side to bring rates applicable elsewhere in review for possible adjustment," (Bf. p. 5) strangely ignores paragraph 3 of appellant's answer before the commission (R. 20-24), and the extended argument of the commission itself (R. 29-32) on this identical subject.

Appellees' attempted explanation of "how the new rates were determined by the commission" (Bf. p. 5) can only be regarded as a somewhat unhappy effort which quite fails to achieve an explanation, for they are compelled to confess that "it is not entirely clear" how the commission arrived at the gateway charge of $.0172. They can account, as we can, for $.0139 of the figure but the remainder of $.0033, which the commission added, arbitrarily and with no evidentiary support, to cover depreciation and return on power system property, they neither explain nor seek to defend.

Appellees' assertion (Bf. p. 29) that the master in his calculations used actual cost of electrical energy "as carried on books of company" may easily be misunderstood, and calls for comment. As explained at pages 11 and 64 of appellant's brief, in the testimony (R. 310 and 311) and by the master himself (R. 127-128) the supposed "gateway" cost "as carried on books of company" is nothing more than a bookkeeping figure representing the average cost to appellant of all electrical energy supplied, including deliveries to affiliated utilities. If appellant's constitutional rights were to be subverted by bookkeeping averages compiled for managerial convenience it would hasten to set up its books in such a way as to restore the working of the constitutional guaranties. The facts have been fully explained in appellant's original brief, and the master's characterization of his cost figure of $.0133 as the com-

pany's cost of energy "as shown by its own books" (R. 127) is merely a characterization, and nothing more.

Appellees at page 35 of their brief repeat their previous denial that appellant's property is a physical and economic unit; and yet one wonders after reading the ensuing discussion (pp. 35-39) as to the basis for the denial, for all of the facts which they recite serve only to emphasize the interconnected and interdependent character of the property. It is true, as they say (Bf. p. 39) that Martinsville is a distinct municipality and is a county seat. But this is a mere political fact. It neither adds to nor detracts from the indisputable fact that the physical equipment in that community by means of which energy is distributed to its residents is only a part of the much larger unit of physical equipment which appellant owns and operates as a single and indivisible mechanism. If Martinsville were not a county seat, if it were not even an incorporated municipality, appellant's economic and physical relations with the individuals residing in that geographical area would be in no way altered.

In making a "correction" of appellant's statement that it has established and maintained uniform rates from the same classes of service in cities, towns and communities of the same class, appellees (Bf. p. 40) do not deny that this is essentially true, but assert merely that it has been accomplished by appellant without resorting to a company-wide rate controversy. Just how this circumstance is supposed to detract from the truth of the admitted fact is not understood.

Neither is it apparent what is intended to be established by appellees' reference (Bf. p. 40) to the testimony of the witness Sittinger. The witness stated the obvious fact that if there were to be a gateway cost, based upon

the system as a whole, it would, of necessity, be the same for all cities and towns and all power customers, and he expressed the personal view that this result would be equitable; but he did not state that the same cost should prevail as to interutility deliveries of power. On the contrary, a reference to his testimony (R. 226-227) will show that he was pointing out, as an engineer, the practical impossibility, because of frequent changes in operating conditions, of making an allocation of a portion of the whole system to a particular city. If this case is to be determined by the personal views of witnesses as to what constitutes an equitable result, reference may be made to the views of appellees' witness Abbett, who, in tendering his advice as to how the case should be decided, did not contemplate putting everybody—big power users and Martinsville—on the same average rate, but thought that if some were served for less, others should pay more to make up the average (R. 257) and who doubted that the affiliated companies would take any power if required to pay the average rate (R. 256).

Appellees' quarrel (Bf. p. 40) with the word "offers," in connection with appellant's calculated Martinsville gateway cost of $.024996, descends almost to a quibble. It is quite true that "no such charge is made in fact" but it is also true that appellant does not offer energy at the Martinsville substation, for local distribution in Martinsville, at a cost of $.0133 per k. w. h., the cost claimed by appellees, there likewise being no such charge in fact. Both figures are calculated figures, arrived at by mathematical processes in an attempt to show what true cost is, all factors considered. Appellees seek to establish that the cost should be found by an averaging process, which includes all interutility and wholesale deliveries on a flat k. w. h. basis. Appellant insists upon a classification which

gives separate treatment to deliveries to affiliated utilities. The separate treatment is not only justified, but is imperatively required if a gross injustice is to be avoided. All of the evidence shows that appellant cannot secure energy for its customers at a low cost without joining with the affiliated utilities and maintaining its share of the transmission lines in its territory, whereby all are able to avail themselves of the economies of the Dresser plant.

Incidentally, appellees' discussion of this point contains an error of fact. They (Bf. p. 41) erroneously apply to deliveries to affiliated utilities a line loss figure of 10.7 per cent as representing energy lost in transmission. This is the average line loss for appellant's system as a whole (R. 291). The actual line loss on deliveries to Northern Indiana Power Company is only 2.1 per cent and on deliveries to Attica Electric Company 8.75 per cent (R. 108).

I.

The Operating Unit Is the Rate Base.

Appellees categorically deny (Bf. p. 72) the existence of any constitutional principle which precludes state authorities from forcing the earnings of a utility property as a whole to a confiscatory level by reduction of rates to certain selected consumers. They are driven to this denial, for despite their efforts to minimize and becloud the fact, the evidence shows and the master himself found that the earnings of the property as a whole in 1929—when the rates at Martinsville were higher than those here in question—were only 4.15 per cent upon the value as found by the master himself, a value which appellees are strenuously defending in other connections.

If there were no constitutional principle which precludes a state from confiscating property by acting upon only a portion of a utility's total rate structure, then much that has been said by this court in the past would be meaningless. This court has said that so long as the total revenue is enough to furnish a return upon the whole property it is not important that with relation to some customers the price is not enough (*Willcox* v. *Consolidated Gas Company*, 212 U. S. 19, 54); that it is enough if the commission shall so adjust street railway fares as to yield a fair return upon the property as a whole, even though a particular line which is an integral part of the system is not profitable at such fares (*United Railways* v. *West*, 280 U. S. 234, 252); that the correct test of the constitutionality of a state statute fixing railroad passenger fares is as to the effect of the act on the railroad's entire line and not upon a single part which was formerly acquired by consolidation (*St. Louis & San Francisco Railway* v. *Gill*, 156 U. S. 649, 665); that where a street railway company's earnings are remunerative as a whole, this court will not hold a commission's order fixing fares to be confiscatory by referring to its effect upon the earnings of certain specified lines which constitute only a part of the entire system (*Puget Sound Traction Co.* v. *Reynolds*, 244 U. S. 574, 580); that where a utility complains of a particular rate fixed by a commission but makes no claim that the loss alleged would render its business as a whole unprofitable and makes no showing as to the value of its entire property or of the rate of return being earned thereon, the evidence does not suffice to show the order legally unreasonable (*New York & Queens Gas Co.* v. *McCall*, 245 U. S. 345, 350). But these pronouncements cannot be true unless their necessary corollary is also true. The announcement of the principle, as Mr. Justice Holmes once

remarked, carries with it the necessity of accepting the next step which the logic of that principle requires. So, if it be true that the protection of the constitution may not be invoked to prohibit as confiscatory a rate affecting only a part of a utility's customers where the property as a whole is earning a fair return, it is also inevitably true that where the earnings on the property as a whole are already at a confiscatory level the constitution forbids the state to force such earnings still lower by singling out for decrease a single rate or group of rates applicable to only a part of the customers. If, as appellees say, there is no constitutional principle prohibiting such action in such circumstances, then the time has come to confess that a method has been found to accomplish public expropriation of private property without compensation without fear of federal intervention. Though a utility may have —as appellant has—lawfully extended its interconnected property over wide areas, with perfect legal right to do so, and with the express approval of the state authorities for the issuance of the securities with which to finance the operation, and with every economic and social justification for the undertaking as a whole, the way will still be open for subsequent state regulatory bodies to single out those congested geographical areas in which the earning power of the property is most assured, and by the device of theorizing as to the allocation of certain portions or percentages of the property to the use of these congested areas, reduce the revenue in such areas, leaving the remainder of the enterprise to languish and ultimately to be abandoned and withdrawn from the public service. This is not an alarmist picture. No business enterprise was ever conducted which did not show greater earning power in some branches and in some areas than in others. A company operating an extended interconnected electric util-

ity system is peculiarly subject to the necessity of looking to the revenue derived from the system as a whole because of the wide variations in the earning power of the property as between congested centers of population and thinly settled rural districts. If the destructive and antisocial doctrine contended for by appellees is to prevail, and an interconnected electric utility may no longer rely upon the earning power of its system as a whole, a vital blow will have been struck at the economic development of the electrical industry, the debilitating consequences of which will become progressively apparent in years to come.

The Fourteenth Amendment to the constitution provides that no state shall "deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." As applied to this case, what property is protected?

Suppose the public service commission law permits one customer to file a complaint concerning the rates in which he is interested. Suppose a domestic lighting customer, living adjacent to the generating plant, makes such complaint. Can this customer validly assert that the only property to be valued is that necessary to serve him? Surely no one would contend that the issue was so limited. Why is it not so limited? The answer is not that a reasonable or practicable unit must be taken, nor that the statute fixes the rate unit. The reason is that the utility never dedicated its property to the service of one customer. The utility is serving the public. The property devoted to the service of the public as an operating unit is the rate base. In a confiscation case no part of that property can, as against the objections of the utility be made the rate base. The appellant in this case is not serving the 17 customers separately, who complained to the

Public Service Commission of Indiana concerning Martinsville electric rates. It is not serving the inhabitants of the city of Martinsville separately. It is serving no one customer, group of customers or classification of customers separately. It is serving no city or geographical subdivision separately. It is serving the public of 50 towns, cities and communities from one electrical property, interconnected throughout and constituting one integrated operating unit. It devoted its property in this operating unit to the public service. To dismember and break it down into several geographical units of utility service deprives the appellant, as owner of the property, of its right of management and control. To break up the system into rate units confiscates the only substantial value the property has—its earning power—by making it impossible for the appellant to earn on the part that serves the sparsely settled communities.

Appellees, denying the existence of effective power in the constitution to prevent the kind of confiscation which was practiced here, attempt to buttress their position by asking (Brief, p. 72-3) whether, if the Martinsville rates were twice as high as they are, "and thus admittedly unreasonably high," anything in the constitution would preclude an order lowering them, regardless of the effect upon the earnings of the property as a whole. We retort by asking who has "admitted" that such rates, considered in their effect on the earnings of the property as a whole, would be "unreasonably high"? Suppose this property were a local one, limited to Martinsville alone. Can it be said that the state would have power forcibly to lower one class of rates, say residential rates, over the company's objection that the earnings of the property as a whole should be considered, if the effect of this action, coupled with inaction or inadequate action as to the other classes

of rates, would be to reduce the earnings of the Martinsville property as a whole to a confiscatory level? An affirmative answer would leave the result—nothing less than a mockery—that when, as in the above cited cases, a utility seeks relief from certain rates on the ground that they are inadequate when considered in connection with a segregated part of its system, it is told to look to the earnings from the system as a whole; but when it seeks relief from the imposition of certain rates for particular customers because the earnings of its system as a whole are thereby rendered inadequate, it is to be told that the rates in question will not be disturbed if, when considered in relation to a segregated part of its system, which will be regarded as attributable to the use of those particular customers, they can be found compensatory. To put it shortly, if, on the one hand, a utility property is not protected piecemeal, but only as a whole, when piecemeal protection is sought, and if on the other hand, it is not to be protected as a whole, but only piecemeal, when protection as a whole is sought, then it is easy to see that a commission may achieve any rate reduction it desires by dealing with a utility's rates one at a time, and that all real protection of utility property is gone. This is exactly where appellees' argument leads. It is destructive doctrine, as destructive to the ultimate interest of utility consumers in whose supposed aid it is here invoked as to the interest of the utility investors against whom it is directed.

If appellees mean that a rate may in its nature be so "unreasonably high" that it is a constitutional thing, for that reason alone, for a commission to reduce it in disregard of the constitutional protection of private property, then we answer that there is no such rule, and could not be, for it would allow a commission a free hand at any

time to evade the constitution merely by invoking the rule. A rate may be unreasonably high from the standpoint of promotion of the company's business or of the personal fortunes of local politicians, but it is never, and can never be, "unreasonably high" in the constitutional sense if a forcible lowering of it would reduce the utility's earnings to the point of confiscation. For the devotion of the property to public service is not a compact to accept less than a fair return on it in any circumstances whatever. No matter how high the rates must be to show a fair return, the utility is entitled to place them that high and no power resides in the state to force them lower. A utility is not obliged in any case to operate its property for the benefit of those who do not care to pay for it (*Brooks-Scanlon Company* v. *Railroad Commission*, 251 U. S. 396, 399). This rule is a social necessity, for it is readily appreciated that under any other principle utility property would rapidly be driven from use and the service would cease. This court made it clear that all other considerations affecting charges for utility service must yield to the right of the owner of the utility property to realize a fair return upon it, when in *Atlantic Coast Line* v. *North Carolina Corp. Comm.*, 206 U. S. 1, 24-25, it said:

> "In a case involving the validity of an order enforcing a scheme of maximum rates of course the finding that the enforcement of such scheme will not produce an adequate return for the operation of the railroad, in and of itself demonstrates the unreasonableness of the order."

If appellees, by their example, wherein they assumed that Martinsville rates were twice as high as they are "and thus admittedly unreasonably high" mean that appellant must admit that such rates would be "unreasonably high" because they would produce such large net earnings upon

some segregated portion of appellant's property supposed to be attributable to Martinsville use, they are, of course, merely begging the question; for such rates could not be "admittedly" too high from that standpoint unless appellant had somewhere admitted the correctness and legality of the allocation basis of testing the rates—something appellant has consistently denied throughout this case.

Appellees in the end attempt to justify the action of the district court in separating Martinsville from the remainder of appellant's property by referring, as the district court did, to provisions of the Indiana statutes. Paragraphs 12773 and 12774 of Burns' Ann. Ind. St. (1926 ed.) provide that every franchise granted to a public utility shall have the effect of an indeterminate permit subject to the provisions of the utility act. Paragraph 12743 provides that the commission shall "by order fix just and reasonable rates * * * to be imposed, observed and followed in the future in lieu of those found to be unjust, unreasonable, * * *." Paragraph 12728 provides that upon complaint made "by any mercantile, argicultural or manufacturing society or by any body politic or municipal organization or by ten persons, firms, corporations or associations or ten complainants of all or any of the aforementioned classes, or by any public utility," that any rates in which the petitioner is directly interested, are unreasonable or unjustly discriminatory, the commission shall proceed to make such investigation as it may deem necessary. These are the provisions upon which appellees rely. From these provisions they argue that the municipality was designated as the ratemaking unit in utility regulation; and that appellant by accepting and operating under an indeterminate permit consented to fixing rates applicable only in Martinsville without reference to their effect upon its total revenue or earnings.

A short answer to the entire contention, even if this construction of the act were conceded *arguendo*, is that acceptance of a license or franchise will not require the party accepting it to respect or to comply with any provisions of the state statute that are repugnant to the constitution of the United States.

W. W. Cargill Co. v. *Minnesota*, 180 U. S. 452, 468.
Blake v. *McClung*, 172 U. S. 239, 255.

But looking at the statute itself it is apparent that appellees' construction of it is so far-fetched as to be wholly inadmissible. It seems as clear as the English language can make it that the statute merely specifies the persons or organizations who may appear before the commission as complainants. It contains no word or hint as to what shall constitute a ratemaking unit or what quantity of property shall be regarded as the rate base in any particular controversy. There is not one word, we submit, in the above quoted provisions which can be tortured into an agreement by an Indiana utility operating an interconnected system in two or more municipalities that a rate or rates charged by it in one of such municipalities may be forcibly lowered by considering only such part of the property as may be thought by some one to be useful to that municipality alone.

A few illustrations will show the highly imaginative character of appellees' reading of the above provisions. If ten merchants in Martinsville should complain of the commercial electric rate, would the rate unit be the city of Martinsville or would it be an allocation within that city of some portion of appellant's Martinsville property supposed to be capable of identification as useful to persons in Martinsville affected by the commercial rate? Or if ten residential customers complained of the residential rate, what would be the rate making unit and what prop-

erty would be considered the rate base for the determination of that narrow issue?

If a municipality is to be taken as the rate making unit, simply because of the circumstance that the statute permits a "municipal organization" to appear as a party complainant before the commission, a question still remains, *what* municipality is intended? A city in Indiana is a municipality. But so is a town (*i. e.* township)—a rural territorial division, governed by an elected trustee. And so is a county, which is governed by a board of elected commissioners. If the complainant before the commission chances to be a county, acting through its elected representatives, then does the county in that case become the ratemaking unit? If a town, acting through its elected trustee, should choose to appear and complain of rural rates charged within its boundaries—as it plainly could under the statute—would the town be the ratemaking unit, and would it be the duty of the commission to allocate a percentage of the total system to the use of that town? Does the ratemaking unit, in other words, depend upon which particular type of Indiana municipality or political subdivision—the statute expressly mentions political subdivisions as well as municipalities as being proper complainants—chances to appear before the commission? Is there to be a different ratemaking unit in each case, the nature and extent of the unit being controlled by the character of the complainant? Why select the city rather than the county or town as the only "municipal organization" intended? These are not frivolous inquiries. They are profoundly important, for they go to the very root of the district court's action, in spelling out of the statute the conclusion that the legislature intended the city to be the ratemaking unit. In Indiana a city is no more definitely a "municipal organization" than is a town or a county, and

certainly it is no more definitely a political subdivision than either of the others named. In Indiana there are many types of "municipal organization" and "body politics" *e. g.* counties, civil townships, civil cities, civil towns, school townships, school cities, school towns, or any other territorial subdivision of the state recognized or designated in any existing law. Par. 10264.2 Burns' Anno. Ind. St. Supp. 1929. Or, still following the statute, suppose a statewide agricultural society or organization of merchants or of manufacturers (all of which organizations exist in Indiana as in other states) should complain to the commission of the rural rates, or the power rates, or the commercial rates, as the case might be, charged by appellant in the entire thirteen counties which its property covers. What then would be the rate making area? It could not be less, under appellees' interepretation of the act, than the thirteen counties in question.

A further example will demonstrate the utterly indefensible character of the construction of the statute contended for by appellees. By definition, under the Indiana statutes, electric street and interurban railways are public utilities subject to the jurisdiction of the commission. They operate under indeterminate permits and are committed to commission regulation to the same extent, exactly as are electric utilities. The interpretation adopted by the district court, which appellees are here attempting to defend, would make a city a ratemaking unit in the case of an electric railway as certainly as in the case of an electric utility. For there can be no question that under the statute any city may complain to the commission with respect to the rates charged by an interurban railway which operates within the city limits. In rare cases a street railway is located wholly within the political boundary lines of the city. But in most cases, as an economic necessity, it ex-

tends beyond those boundaries in the suburban area, as everyone knows. And in the case of electric interurban railways, their passage through cities located along their lines is a mere incident in their operations. If appellees are right, then fares fixed by a street or interurban electric railway for service within the city could be tested by relating the net income from such intracity service to the segregated part of the railway property used or useful in rendering such intracity service without regard to the effect of the earnings upon the railway system as a whole. But this is not the law.

St. Louis & San Francisco Ry. v. *Gill,* 156 U. S. 649, 665, 666.

Puget Sound Traction Co. v. *Reynolds,* 244 U. S. 574, 580, 581.

United Railways v. *West,* 280 U. S. 234, 252-253.

An interurban railway serving fifty communities located along its line is so manifestly a single physical and economic unit that no one would seriously question the fact. Yet in the modern state of the art of transmitting and distributing electricity an interconnected electrical system supplying fifty communities located along its line or lines is fully as unified and integrated in its physical and economic character.

The simple fact is that the construction placed on the Indiana statutes by the district court disregards their plain language. Every circumstance useful as an aid in construing that language leads to the conclusion that the legislature meant what it plainly said. The legislature presumably had in mind the strong economic and social reasons which make it desirable from the standpoint of the public to have the agricultural and sparsely settled parts of the state, as well as the municipalities, supplied with electricity

at reasonably cheap rates and, therefore, to have the entire property of the utility and not the property in any congested area, such as a municipality, the unit for ratemaking purposes.

The vital section of the Indiana Public Service Commission Act, Section 9, in the first sentence states:

> "The Commission shall value *all* the property of every public utility actually used and useful for the convenience of the public." (Vol. 3, Burns' Ann. Ind. Stats. 1926 ed. Sec. 12680.)

The district court in construing this section (R. 147) said:

> "This section refers to the property that is used and useful in connection with the furnishing of a utility to any municipality under consideration, in this instance Martinsville."

In other words, the district court simply wrote into the statute language which it does not contain. This action was, we submit, an inexcusable piece of judicial legislation. If such had been the intention of the legislature, it would have been an easy thing so to have drafted the statute as to make it clear that the unit for ratemaking purposes was to be the city and no other unit. But the legislature did not say that. It said that *all* the property of the utility, which property might extend beyond the limits of any single municipality, should be valued, and it provided in Section 11 that, after the valuation was determined, a statement thereof should be filed with "* * * the Clerk of each municipality in which *any part* of the plant or equipment of such utility is located." (italics ours) (Vol. 3, Burns' Anno. Ind. Stats. 1926 ed. Sec. 12682.) We submit that that language is not ambiguous; that it means exactly what it says; and that it is so clear that evidence outside of the statute itself cannot be used to interpret its meaning.

But if arguments as to what the legislature is presumed to have intended are to be used, it will be found that the arguments of the commission and of the district court are based on such a misconception of the historical facts as to be wholly misleading and unpersuasive. From the statements in the opinion of the district court, one would think that the state of the electric industry in 1913 was such that *no* electric company owned any property outside of the limits of a particular municipality. The court said (R. 146 and 147):

> "Prior to the year 1913, each municipality, through its officials, was charged with the duty of providing public utility service for such municipality and the inhabitants thereof, and was, under the law, given ample power to perform such duty. Practically every municipality within the State, the size of Martinsville, had a light and power plant, owned either by such municipality or by a private corporation. * * * At the time of the passage of this Act, the development of electrical power plants was in its infancy, as compared with the present day. The one thing that was uppermost in the minds of the legislators, in enacting this legislation was to bring about reasonable rates and adequate service on the part of the utility on the one hand, and the municipality and its inhabitants on the other."

The vice with this argument is that it is founded on an entirely erroneous assumption as to the state of the electric industry in the year 1913. The statement is not based upon any evidence in the record. The court seems to have drawn the inference that because appellant's system was conceived and assembled in 1923, no interconnected electrical system was in existence ten years before that. Not

only is the assumption unsupported by any proof, but it is diametrically opposed to the historical facts. The truth of the matter is that by the year 1913, the development of the central station plant and high power transmission lines was such that it was obvious to everyone that the unit of the electric operating company of the future was not to be a municipality but a much larger territory. Quotations in the appendix at pp. 54-55 of this reply from McGraw's Electrical Directory show the names of utility companies in Indiana serving more than one community in 1913 and the number of communities served. The state of the development of the electric industry in 1913 is excellently shown by reference to a book issued by the United States Department of Commerce, Bureau of Census, in 1912, entitled "Central Electric Light and Power Stations and Street and Electric Railways, with Summary of the Electrical Industries, 1912," Government Printing Office, Washington, D. C. A few quotations from this book appear in the appendix to this brief at pp. 47-53.

These quotations show conclusively that the statement of the court as to the condition of the electric industry in 1912 is wrong, and that its conclusion as to the intentions and purposes of the Indiana legislature is without foundation in fact. The legislators must be presumed to have known the facts as to the development of the industry and the state of the art, not as the district court wrongly understood them, but as they were. They must have known that the days of separate electric plants for separate municipalities were over or were definitely numbered. They must have known that the operating unit of the future was not to be a municipality but a system embracing probably numerous municipalities. Presumably what was "uppermost in the minds of the legislators, in

enacting this legislation," was not to settle disputes between a municipality on the one hand and an electrical company on the other, but to provide state control of electrical companies which had extended or were about to extend beyond the bounds of municipalities and which, therefore, the existing system of municipal control was utterly inadequate to handle. It was obvious that, if an electric operating system covered numerous municipalities and certain rural districts, an attempt by each separate municipality to fix rates for itself was bound to end in confusion and injustice. The state was, therefore, obliged to step in and naturally provide for a valuation of the operating utility's properties, not merely that property which was located in each political subdivision but of *all* its properties. This the statute specifically does. The fact that the legislature in Sections 11 and 18 expressly referred to utility property only *a part* of which might be located within a particular municipality, conclusively shows that it was cognizant of the development of the art at the time the statue was passed and could no have contemplated a stifling practice of making rates by municipal units.

In enacting the statute establishing a state public service commission, the legislature of Indiana must be presumed also to have had in mind the strong arguments of public policy which would compel a utility, whose properties extended over a considerable territory, to serve the less profitable districts as well as the most profitable. It has been generally considered good public policy to give to the rural and sparsely settled districts of every state postal service comparable to the service rendered in congested communities. It has been considered good public policy to develop the rural and sparsely settled districts by building good roads, even though the traffic on these

roads at the time they were built might not show an adequate return on the cost of their construction considered separately.

For similar reasons, it is good public policy to extend the development of electricity and telephone service to these rural and sparsely settled communities insofar as the same is reasonably possible. One way that this can be done is to permit, or perhaps compel, a utility to extend its lines into districts which are not self-supporting at the time the extension is made but which have a reasonable chance of becoming self-supporting in the future, and, in the interim, to permit the utility to make a reasonable return on all its properties considered as a unit. If a utility is held down to the minimum return permitted by the constitution in the more profitable areas of its territory, it obviously cannot afford or constitutionally be compelled to experiment with the development of any market in territory which is not paying territory and will not become such until developed. The social result of such a policy would inevitably be to make rural life less attractive and to increase the evil tendency to undue concentration of population and industry in the great municipalities. In states where uniform rates for electricity are in existence throughout the entire state, it is possible for industries to be profitably located in sparsely settled communities. This results from the fact that the power rates are the same as they are in the municipalities and the living conditions for the workers are nearly equal in attractiveness. It seems unnecessary further to elaborate the social and economic advantage of such a statewide development as compared with a concentration of population and industry in the cities.

This court itself has pointed out the desirability, in certain cases, of forcing a utility company, if as a whole it

is making an adequate return, to give service in a territory which, considered by itself, might be unprofitable. Thus, in *United Gas Co.* v. *R. R. Commission,* 278 U. S. 300, at 309, the court said:

> "The primary duty of a public utility is to serve on reasonable terms all those who desire the service it renders. This duty does not permit it to pick and choose and to serve only those portions of the territory which it finds most profitable, leaving the remainder to get along without the service which it alone is in a position to give. An important purpose of state supervision is to prevent such discriminations, see *New York & Queens Gas Co.* v. *McCall,* 245 U. S. 345, at p. 351, and if a public service company may not refuse to serve a territory where the return is reasonable, or even in some circumtances where the return is inadequate but that on its total related business is sufficient, *Atlantic Coast Line* v. *N. Car. Corp'n Comm.,* 206 U. S. 1, at p. 25; *Missouri Pac. Ry. Co.* v. *Kansas,* 216 U. S. 262, at p. 277, it goes without saying that it may not use its privileged position, in conjunction with the demand which it has created, as a weapon to control rates by threatening to discontinue that part of its service if it does not receive the rate demanded."

In this country fortunately the doctrine of regarding the municipality as the unit has not generally prevailed, and as a result there has been an extension of electric service throughout the country which would have been impossible in any other system. This is evident from an examination of the decisions of the Public Service Commissions referred to on pages 60 and 61 of the brief for appellant.

Not only has the tendency been to treat the system as a unit for ratemaking purposes but the tendency has been toward more uniformity in rates throughout the entire territory. This tendency has resulted from the initiative of the utilities themselves and also from the pressure put on the utilities by progressive state utility commissions and progressive governors of states. In an address at the Syracuse, New York, State Fair on August 29, 1929 (reported in the "New York Times" of August 30, 1929,) Governor Roosevelt pointed out that it costs the same amount per mile to travel on the main line of the New York Central Railroad where the traffic is heavy as on a small single track road in a sparsely settled section and said:

> "This is on the theory that, even though there may be little or no profit to the railroad in running passenger trains on a branch line, it should be made up for by the profit on the heavily traveled section of the road."

He then advocated applying the same principle to electric utilities.

In certain states, this principle has been applied and uniform rates are found throughout the entire state. Professor Philip Cabot of the Harvard University School of Business Administration, in an address before the American Bar Association in October, 1932, in expounding the advantages of systemwide rates, said:

> "Let me interrupt myself to give an illustration of what I have in mind. In domestic lighting in the electrical field in thickly settled areas near the station, you can provide that service profitably at 2½ or 3 cents a kilowatt hour. But 20 miles from the station or 50 miles from the station it cannot be done at anywhere near that price. If you begin with a low

price such as 2½ or 3 cents, the result is either (*sic*) that no service is supplied outside of a narrow area. That is what happened in England to a large extent. The municipal authorities there began with very low rates and a very short way from the center of the cities you find no electric service, whatever. I spent the summer in England in a house, and in neither that house nor any of the neighboring houses was there any electric service at all. It is unthinkable in this country.

"If you do not refuse to serve, the other method is to use a mileage rate. If a man is ten miles from the station, he will pay a higher price than the man who is three miles from the station. If he is 20 miles from the station, he pays a higher price still.

"Both those methods have been tried and both have failed. Under neither one do you develop the maximum volume of business, and the reason is, I think that you violate the principle of value of service. The value of service is the same to the man 20 miles from the station as to the man 2 miles away, and if you ask him to pay two or three times as much, he is rather likely to say no, even if he can afford it.

"In the United States we have avoided both those errors in general. We maintain uniform prices over very large metropolitan areas. The principle is sound and we have here very much larger developments than could possibly have been obtained by any other system of rate making."

The decision of the district court, in upholding the decision of the commission in the construction of the Indiana statute so as to compel the commission to use a municipal rather than a system-wide rate base, and in holding

that the order of the commission, based on a municipal rate base and in disregard of the property outside of the limits of the municipality, is lawful, is a decision which, we submit, is not only contrary to the constitution and the law but is, in its economic and social results, reactionary and anti-social. It cannot be presumed that the Indiana legislature intended such a result.

It is manifest that appellees have concentrated upon the words "municipal organization" in section 57 of the Indiana statute and ignored all of its other language for no better reason than that it serves their immediate purpose in this lawsuit. But their interpretation of the statute outrages every tenet of construction. If they can make the statute say that a city was intended by the legislature to be the required ratemaking unit, then they must admit that it also, in the same breath, says other things directly contradictory to that statement, *i. e.*, that any political subdivision other than a city is also the required ratemaking unit or that any area represented by any of the other numerous types of complainant is also the required ratemaking unit. But these things cannot all be true. They are mutually destructive. A logical application of appellees' reasoning leaves the whole subject in a hopeless state of confusion and drives one back to the sound conclusion for which the simple and straightforward words of the statute call, namely, that the legislature was merely defining the procedure by which rate inquiries could be initiated and specifying the types of complainant who might properly institute them, with no suspicion that in so doing it was defining ratemaking units or providing for the carving up of widespread utility properties along local political boundary lines.

The point, we feel, deserves the emphasis which we give it, for it was upon this very point that the district court

fell into the error which caused it to forget its constitutional duties in this case. Being unaided by any decision of the Indiana state courts it elected to be influenced by language by the Supreme Court of Wisconsin in the EauClaire case, 178 Wis. 207, 189 N. W. 476, in dealing with a similar statute. But it overlooked the fact that the issue before the Wisconsin court was the very converse of the one with which the district court was dealing, and that any language of the Wisconsin court should be read in the light of the question then before it. What the Wisconsin court decided was that where the total earnings of an interconnected electric system were adequate, a city located near the source of supply—a hydroelectric dam—could demand lower rates than one located further away. The Wisconsin court was apparently influenced considerably by the fact that the nearer city had previously enjoyed cheaper service by means of a local plant—a fact not paralleled here, for Martinsville is substantially benefitted by being a party to the interconnected system. But the Wisconsin court did not have before it and did not decide that the commission by any discrimination between communities could reduce the total earnings of the interconnected system below a compensatory level.

The other cases relied upon by appellees are no more pertinent.

The case of *Hardin-Wyandot Lighting Company* v. *Public Utilities Commission of Ohio,* 118 Oh. St. 592; 162 N. E. 262, is not in point because it assumes the question involved in the case at bar. The Ohio court merely held that property not used and useful in serving the territory should not be valued. Here the question is whether a municipality can be segregated from the rest of an interconnected system where all the property in the system is clearly used and useful in serving the territory as a whole.

The cases of *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, and *Minnesota Rate Cases*, 230 U. S. 352, do not support appellees' contention. Those cases are cases where it is necessary to separate intrastate and interstate revenues and expenses because it is essential to the appropriate recognition of the competent governmental authority in each field of regulation. The Minnesota rate cases show that all the business in the state was taken into consideration.

If the contention of appellees is correct, then the rule announced in *St. Louis & San Francisco Ry.* v. *Gill*, 156 U. S. 649, at 665-666, and followed in subsequent cases, is wrong and the utility will hereafter be entitled to claim the right to earn a net profit from every mile, section or other part into which its property may be divided. There is no more logical reason why the city is to be taken as the rate area than any other geographical subdivision which may be invoked. The constitutional protection is to the entire property dedicated to public use and has no relation to the geographical areas in which the property may be located.

In *Interstate Commerce Commission* v. *Union Pacific R. R. Co.*, 222 U. S. 541, 549, the commission had fixed rates on lumber. The question concerned the rates on a single article, *i. e.*, lumber, and questioned them on the ground they were unreasonable and unremunerative. The evidence showed the rates as a whole were not confiscatory. The case thus is different from the one at bar where the rates as a whole are confiscatory. The rates as a whole being compensatory the question turned on the reasonableness of the rate on lumber alone, and the case was decided on that issue.

Certain other suggestions of appellees may be mentioned.

Appellees assert that "no evidence was introduced to show that Central Indiana Power Company as the real owner of the whole affiliated system used or operated as a whole was not getting a fair return on the whole" (Bf. pp. 47 and 75).

Central Indiana Power Company is a holding company, owning the stocks and bonds of the affiliated companies. It owns no utility properties and operates none. The contention that the court can look through the corporate form of appellant and say that Central Indiana Power Company as the owner of its stock and bonds is the owner of the property of appellant and of the other affiliated companies is clearly an unsound legal conclusion. The fact of separate corporate existence cannot be disregarded and the fiction of corporate identity substituted. The decision of this court in *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133, 143, 144, furnishes the answer to the suggestion. This court there held that the Illinois Bell Telephone Company was the proper plaintiff notwithstanding the control of its stock by the American Telephone and Telegraph Company. If the contention of appellees were sound it would mean that the American Telephone and Telegraph Company as the holder of the stock of the Illinois Bell Telepone Company and of other large operating telephone companies would have to show it "was not getting a fair return on the whole." It is clear that the interconnections of the various telephone corporations of this country are more far reaching and have achieved a further stage of development than has the system of the affiliated utility corporations, the stocks of which are owned by the Central Indiana Power Company. Appellees, by making this contention, in fact contradict their argument that Martinsville alone is the rate unit.

Appellees claim (Bf. p. 63) that the testimony of appellant's witness Spooner supports their contention that no property is used and useful in serving Martinsville except the Martinsville local property and an apportionable part of the power system. Appellees appear to be resorting to the opinion of a witness as to how this case should be decided. However, an examination of the record shows he made no such statement. He merely stated the obvious physical fact that only the Martinsville local property is utilized in distributing electricity within Martinsville, and that local property outside Martinsville is not used in bringing electricity to Martinsville (R. 205). This does not change the fact that appellant's public utility system, serving 50 towns, cities and communities, is a single operating unit, both physically and economically, and that Martinsville, is an integral part of that public utility system. Even within Martinsville not every wire is used to carry electricity to every customer.

Appellees argue (Bf. p. 37) that the power system property of appellant was not conceived for its purposes only, but that its transmission lines were conceived and created as a comprehensive part of the whole power distribution system of the affiliated companies. We have explained the development of the affiliated system. Economic necessity brought the system together. No one of the affiliated companies had an electrical demand large enough to make a large generating plant commercially expedient. It is conceded by every one of the five engineers who testified for appellant, and the three who testified for appellees, that power can be generated much more cheaply in a large generating station, and distributed by transmission lines to the customers at less cost, than it can be generated and supplied in small local generating plants. All concede that Martinsville is better off by being supplied

from the appellant's system. Obviously, transmission lines must be built that will coincide with the system demand. Each of the affiliated companies built the necessary transmission lines in its respective territory. Appellant invested more in transmission lines but it saved much more in generating equipment and the net result was a saving in capital investment. A cheaper power supply was secured. It is not disputed that appellant and its customers benefit as a result by getting cheaper energy and also by getting a more reliable and dependable supply. Appellees demand that apepllant shall secure all the benefits and pass them to its customers free of the fair reciprocal burden that necessarily goes with the building of the system. The unanimous agreement of the engineers who testified, that the system is a beneficial one supplying power over the transmission lines at less cost than it can be generated in small local generating plants, plus the presumption of fair and honest dealing that must be accorded appellant, establishes the justification for appellant's action in the construction and operation of its system. There is a substantial reciprocal benefit to each of the affiliated companies from the operation and uses of the system by all. The lines are connected so as to form a loop that will insure service to the communities from either direction. If a break in the line stops the normal flow of current, it will flow in from the opposite direction. This benefits all by saving reserve transmission lines which would otherwise become necessary. It affords all a means of emergency and reserve supply in case the normal supply is for any reason interrupted. Of course, reserve and energy supply is never large in volume, but it is vital to the company and customers, and must, at all times be available as the means of affording dependable, reliable and continuous service. The plan does this and

thereby affords each a substantial reciprocal use in the lines of the other. Considering the actualities, it is seen that appellant's property was built and designed for the ultimate benefit of appellant's customers, and that that benefit has been achieved.

Appellees seem to contend (Bf. p. 66) that because appellant has voluntarily filed rates which give it less than a fair return on its system property, it cannot complain. Whether appellees intend to offer this as an excuse for the consfication practiced by the commission we do not understand. If so intended it is a sufficient answer to point out that while a utility may as a matter of policy forego a fair return, a commission cannot constrain it to do so.

> *Great Falls Gas Co.* v. *Public Service Com.*, 34 Fed. (2d) 297, 298.

Appellees' entire case, in the last analysis, is grounded upon their argument, based upon their construction of section 57 of the Indiana statute, that the city is the required rate unit. Since the statute has never been construed by the state courts of Indiana on the point contended for, and the question here presented is a constitutional one, the ordinary reluctance of this court to construe a state statute disappears, and it becomes not only the power and right of the court, but also its duty, to determine the true meaning and effect of the language used by the Indiana legislators. Where the jurisdiction of the federal court is properly invoked upon a substantial controversy arising under the constitution of the United States, the jurisdiction of that court, and of the supreme court on appeal, extends to the determination of all questions involved, including questions of state law, irrespec-

tive of the disposition that may be made of the federal question and whether it be found necessary to decide it at all.

Siler v. *Louisville & Nashville R. R. Co.*, 213 U. S. 175, 191.

Greene v. *Louisville and Interurban Railroad Co.*, 244 U. S. 499, 508.

Hopkins v. *Southern California Telephone Co.*, 275 U. S. 393, 399.

Edward Hines, Trustees v. *Martin*, 268 U. S. 458, 463.

Prentis v. *Atlantic Coast Line*, 211 U. S. 210, 226, 227.

The decision in this case will of necessity stand as a landmark in the field of public regulation of the interconnected electric utilities which have done so much in the last few decades to advance and quicken the development of the nation. The attempted economic isolation of local communities which is implicit in appellees' argument is distinctly contrary to that fortunate breaking down of the barriers of time and space which has been such a distinctive development in this country in recent years. If by the nibbling process which they advocate, which is essentially opportunist in character, neighboring communities which should cooperate are to be encouraged instead to seek temporary selfish advantage at each other's expense, then the development of the electrical industry must pause for a generation until our social philosophy and resultant legal concepts again come abreast of our scientific achievement.

II.

If Martinsville Is to Be Segregated.

If Martinsville is to be separated (a) the allocation of power system property to Martinsville use, and (b) the fixing of a "gateway" cost for electric energy supplied Martinsville, must be on an actual use basis and not by averaging.

When appellees argue that the segregation of power system property and the fixing of a "gateway" cost for electrical enery was on an actual use basis they ignore the undisputed facts. To allocate property fairly and fix a "gateway" price it is necessary to recognize the fact that half the deliveries are to affiliated utilities. In order for appellant to be able to secure power at one cent per k. w. h. from the Dresser plant it was necessary for it to join with the other affiliated utilities in building and operating the high tension transmission system whereby all affiliated companies may secure power from the Dresser plant. The master recognized that this plan was absolutely necessary to make the Dresser plant commerically possible (R. 80). The court admitted that the Dresser plant is the means by which electrical energy is supplied at a minimum cost (R. 144). Appellees now desire to appropriate for Martinsville the benefits of this plan, but to disclaim the reciprocal burdens of the plan. To include, as the commission, master and court did, the deliveries to affiliated utilities, equaling approximately half the total deliveries, and average all on a flat kilowatt-hour basis, is clearly not a segregating of the property according to use, but is a sacrifice of substance and fact to form, resulting in gross injustice and confiscation of appellant's property.

Appellees say that energy is sold by Northern Indiana Power Company to the town of Tipton for $.0162 per kilowatt hour (Ex. 124, R. 320). The master first admitted the exhibits in question, but subsequently excluded them (R. 265-6) for the reason that the exhibits were purely hearsay, related to collateral matters and there was no sufficient showing that the property of the companies referred to in the several exhibits as supplying the various cities, were comparable to any substantial extent with the property of appellant; that nothing was shown in relation to operating expenses or management and there was no satisfactory evidence as to the value of the property involved in the several exhibits excluded. Appellees did not file exceptions to the master's report. Similar evidence was excluded in *Smyth* v. *Ames,* 169 U. S. 466, 540, and in *Board of Public Utility Commissioners* v. *Elizabethtown Water Company,* 43 Fed. (2d) 478. The energy is wholesaled to Tipton and not retailed as in the case of Martinsville. The evidence having been excluded there was no examination in reference to whether the rate was a proper rate at Tipton. The value of the property necessary to serve Tipton and the expense of the service is not shown. Whether the service was at a loss or profit is not known. Obviously the cost to Tipton could not control the cost to Martinsville. The assertion that the energy supplied to Tipton was transmitted to Northern Indiana Power Company over appellant's lines is not correct and is not supported by the evidence in the record. Northern Indiana Power Company obtains power from several sources, and in addition has a large generating plant at Kokomo near Tipton.

We regret that two errors appear in the tabulations set up in appellant's brief, and we desire to correct them.

First. The "working cash" item in the Spooner & Merrill appraisal as it appears in the tabulation at page 25 should be $3,358 (R. 275) instead of $5,358. This error does not change the total of $135,402 because the correct figure of $3,358 is reflected in the total.

Second. In the tabulation at pages 92, 93 and 94 the item of "annual depreciation—4% of $287,915.24—$11,516.60," is wrong. This item should be "annual depreciation—4% of $100,283 (R. 300) on Martinsville local property—$4,011.32." This reduces the depreciation $7,505.28 and this reduction should be reflected in the totals following it. After giving effect to this correction a deficit still remains. It is an error because the "gateway" cost of $.022897 per k. w. h. includes 4% depreciation and 8% return on the power system property (R. 300). Therefore the item of "annual depreciation" following in the tabulation should be limited to the Martinsville local property. The court did not include an allowance for depreciation or return in the "gateway" cost of $.0133 per k. w. h. Therefore the "annual depreciation" allowance by the court is to cover both system property allocated to Martinsville and the local Martinsville property. But the "gateway" cost fixed by the commission and the master included depreciation and return on the power system property.

Since the error in the depreciation item in the tabulation at pages 92, 93 and 94 is reflected in the totals following it we are here setting forth corrected tabulations:

The revenue from the rates complained of, and expenses for the calendar year 1929 are shown to be as follows:

Operating Revenue (R. 168)		$84,750.13
Expense:		
Power—2,532,798 k. w. h. (R. 311) at $.022897 per k. w. h., including 4% depreciation and 8% return on power system property (R. 300)	$57,993.47	
Other expenses, including taxes	21,349.05	
Rate case expense (R. 114)	5,180.65	
Annual depreciation—4% of Martinsville depreciable property $100,283 (R. 300)	4,011.32	88,534.49
(*In red)	Deficit	$ 3,784.36*

The revenue from the rates complained of, and expenses for the year ending May 31, 1930, are shown to be as follows:

Operating Revenue (R. 168)		$81,868.72
Expenses:		
Power—2,528,511 k. w. h. (R. 168) at $.022897 per k. w. h., including 4% depreciation and 8% return on power system property (R. 300)	$57,895.31	
Other expenses, including taxes	20,624.18	
Rate case expense (R. 237)	6,235.98	
Annual depreciation—4% of Martinsville local depreciable property $100,283 (R. 300)	4,011.32	88,766.79
(*In red)	Deficit	$ 6,898.07*

The following comparative statements show the differences between appellant's statements and the tests applied by the court for the same periods (R. 168 and 169):

For the calendar year 1929:

Statement by District Court			Statement by Appellant	
$84,750.13		Operating Revenue		$84,750.13
	$33,726.13	Expenses—Power	$57,993.47	
	21,349.05	Other expenses, including taxes	21,349.05	
	400.00	Rate case expense	5,180.65	
62,250.34	6,775.16	Annual depreciation	4,011.32	88,534.49
$22,499.79—Net			Deficit	$ 3,784.36*

(*In red)

For the year ending May 31, 1931:

$81,868.72		Operating Revenue		$81,868.72
	$33,629.20	Expenses—Power	$57,895.31	
	20,624.18	Other expenses, including taxes	20,624.18	
	400.00	Rate case expense	6,235.98	
61,428.54	6,775.16	Annual depreciation	4,011.32	88,766.79
$20,440.18—Net			Deficit	$ 6,898.07*

(*In red)

If the items of 4% depreciation and 8% return included in the "gateway" cost of $.022897 per k. w. h. (R. 300) are eliminated, the "gateway" cost will then be $624,854.64 divided by 41,032,962 k. w. h., or $.015228 per k. w. h. This cost of $.015228 per k. w. h. is comparable to the cost of $.0133 per k. w. h. used by the court and will result in eliminating depreciation and return on the power system from the "gateway" cost. Restating the tabulations on this basis the results are as follows:

For the calendar year 1929:

Statement by District Court			Statement by Appellant	
$84,750.13		Operating Revenue		$84,750.13
	$33,726.13	Expenses—Power	$38,568.55	
	21,349.05	Other expenses and taxes	21,349.05	
	400.00	Rate case expense	5,180.65	
62,250.34	6,775.16	Annual depreciation	11,516.60	76,614.85
$22,499.79—Net			Net—	$8,135.28

The court applied the return $22,499.79 to a rate base for Martinsville of $204,138 which showed a return of 11% plus (R. 168 and 169). The return of $8,135.28 applied to a rate base of $376,578.19 claimed by appellant (p. 91, appellant's brief) shows a return of 2.16%.

For the year ending May 31, 1930.

Statement by District Court			Statement by Appellant	
$81,868.72		Operating Revenue		$81,868.72
	$33,629.20	Expenses—Power	$38,504.17	
	20,624.18	Other expenses and taxes	20,624.18	
	400.00	Rate case expense	6,235.98	
61,428.54	6,775.16	Annual depreciation	11,516.60	76,880.93
$20,440.18—Net			Net—	$ 4,987.79

The court applied the return of $20,440.18 to a rate base for Martinsville of $204,138 which showed a return of 10% plus (R. 168). The return of $4,987.79 applied to a rate base of $376,578.19 claimed by appellant (p. 91, appellant's brief) shows a return of 1.32%.

III.

Value of Property.

The master rejected entirely the appraisal of Stone & Webster (R. 85, 86). There can be no dispute about this. Appellees are merely quarreling over the use of the word "ignored." When the master rejected the appraisal and gave it no weight he certainly ignored it. There is no escaping the fact that the opinion of the witness Abbett was accepted as to the principal items of property (R. 94, 100, 109, 152). The testimony of William V. Burnell and Carl J. Sittinger of the engineering firm of Stone & Webster and the testimony of Charles J. Spooner and Donald M. Cook of the engineering firm of Spooner & Merrill contra-

dicts the appraisal of Abbett. Why it should be held that the opinion of the witness Abbett was right on unit prices, depreciation and intangibles and that of four more experienced men was wrong, cannot be explained. The undisputed evidence as to the securities authorized by the Public Service Commission from June, 1923, to June, 1927, for the acquisition of appellant's property, the cost of that property as recorded on the books and the earnings from the property corroborates the appraisals of Stone & Webster and Spooner & Merrill. A summary shows the following:

Stone & Webster (R. 277)	$5,828,507
Spooner & Merrill (R. 275)	5,556,091
Securities authorized by Public Service Commission (R. 281)	5,088,100
Cost per books of electric utility property, excluding working cash, materials, supplies and going value (R. 280)	4,940,686
Cost per books, including working cash, materials, supplies and going value (R. 288)	5,627,903
Average annual earnings from 1923 to 1927, before deduction for depreciation (R. 287)	364,209
Dividends paid on common stock from 1923 to 1927 average per annum	4.36%

The finding of the master reducing the value to $4,594,887 (R. 131) is clearly erroneous.

Appellees contend that the cost of financing should be eliminated from the appraisal made to reflect reproduction cost. It cannot be denied that the cost of financing is a

normal item in reproduction cost. The authorities cited by appellees show that an allowance for cost of financing is not proper in showing actual cost where no cost of financing was actually incurred. Here the actual cost is shown by the book cost and does not include cost of financing. On the other hand, the appraisals of Stone & Webster and Spooner & Merrill are to show reproduction cost and it is proper to include in them all normal items of reproduction cost, including cost of financing. The fact that in this particular case appellant was able, through the Central Indiana Power Company, to finance the property without paying an actual charge for cost of financing cannot in any way affect the reproduction value of its property. That reproduction value should reflect all items which normally enter into such reproduction value.

Appellees argue that the unit prices used in the Stone & Webster appraisals were made by one of the men in their office who never saw appellant's property and who never came on the grounds (R. 225). But the unit prices used by appellees' witness Abbett are based on catalogs and quotations, and his opinion on labor performance on mathematical calculations, as he had had no construction experience except in school.

IV.

Rate Case Expense.

Appellees make no attempt to demonstrate how the appellant will be able to pay the expenses of this rate case out of an allowance of $4,000 amortized over a ten-year period at the rate of $400 per year. It is not questioned that the expense of the rate litigation exceeds $60,000. Appellees choose to ignore the fact that two single items of cost (*i. e.* $1,000 for the commission's appraisal, and

$4,500 for the master's fees) aggregating $5,500 alone exceed the allowance of $4,000 for rate case expense. How will the appellant pay for its attorneys' fees, court costs and appraisals? Is it to be penalized in the sum of $60,000 for daring to assert its constitutional rights?

The appellees are seriously in error in asserting that the appraisal expenses incurred in the previous merger hearing before the commission are being charged against Martinsville in this rate case. It appears (R. 237) that all the expenses in connection with the merger were paid for and carried on the books of Central Indiana Power Company and no part of them was charged to the appellant. Instead of charging any of the appraisal in the previous merger case to the rate case, the costs of the rate case were lessened by using the inventory that had been made for the merger case. The fact that the same inventory was used in the rate case as was used in the previous hearing in reference to the merger, is what appellees refer to (R. 203). By using the same inventory, bringing it down to date and reappraising the property as of the later date, considerable expense was saved in the rate case. The commission engineers proceeded in the same manner, in this respect, as did appellant's engineers in making the appraisal.

Although the presumption of honest intent and right conduct support the rate case expense items (*Interstate Commerce Commission* v. *Chicago G. W. Ry.*, 209 U. S. 108, 119), in this case the record contains proof of the expenditures in itemized form (R. 237, 313, 314 and 317).

V.

Rate of Return.

The rate of return is the relation between the net revenue and the fair value of the property. Where the valuation placed on the property is inadequate and the cost of the service had been underestimated, the rate of return should be more liberal.

VanDyke v. *Geary*, 244 U. S. 39, at 48.

It is clear that the testimony of appellees' witnesses supporting a 7 per cent return did not include an allowance for accumulating a surplus. The testimony of appellant's witnesses that 8 per cent return was required to take care of interest on bonds, dividends on stock and the accumulation of a surplus, is undisputed. Appellees now argue that 7 per cent is sufficient for the reason that the surplus of the company on January 1, 1929, was $1,074,739.71 and on December 31, 1929, was $1,257,884.64, an increase of $183,144.93 (R. 313). But appellees overlook the fact that no dividends were paid on the common stock of the appellant during the year 1929 and that the net earnings for the year 1929 as computed by the master (R. 131) were $186,044, which is a return of only 4.15 per cent on the value of the property as fixed by the master (R. 131). There is nothing to show that this surplus shown on the books is an earned surplus. It does appear (R. 280) that no dividends were paid on the common stock during the years 1925, 1926, 1928, 1929 and 1930. The earnings before making allowance for depreciation for each of the years from 1923 to 1930 are shown in Exhibit 20 (R. 287). The annual average earnings thus shown are $364,209.75 (R. 287). It further appears that the highest earnings were in the year 1929 when the total before al-

lowance for depreciation was $450,453.17. If from this is deducted the allowance of the master in chancery for depreciation in 1929 of $202,905 (R. 131) the amount of net earnings would be $247,548, or a return of 5.3 per cent on the value found by the master. It is, therefore, clear that the surplus has been built up out of capital plus earnings which should have gone to dividends.

VI.

What Will the Rates Yield?

The tabulations at pages 37-40 of this reply brief show what the rates will yield. These tabulations, together with the argument in appellant's opening brief we deem sufficient to answer appellees' contentions.

VII.

The Rates Are Confiscatory.

The rates on the entire property are shown to yield less than 5 per cent. If an allocation of property is to be made to Martinsville and the allocation charges to Martinsville its fair portion of the power system property and charges a fair "gateway" price for energy, the rates will yield considerably less than 5 per cent as applied to the Martinsville rate base. The rates are clearly confiscatory.

The judgment of the district court should be reversed.

Respectfully submitted,

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APPENDIX.

The Public Service Commission Act of Indiana, commonly known and referred to as the Shively-Spencer Utility Commission Act, became a law May 1, 1913.

The state of the development of the electric industry in 1913 is shown in a book issued by the United States Department of Commerce, Bureau of Census in 1912, entitled "Central Electric Light and Power Stations and Street and Electric Railways, with Summary of the Electrical Industries, 1912," Government Printing Office, Washington, D. C. The following quotations illustrate the point:

> "Three remarkable developments are associated with the period 1907-12, as contrasted with those of antecedent date, although the results are probably only a continued exemplification of the trend of the art and the irresistible push of the forces that have made it what it is as a centralized source of supply.
>
> "*Consolidation of central stations*—One of these conditions of development has been the marked tendency toward central station consolidation. The process was never more active than during the period 1907-12. * * * Some of these city systems have expanded so as to embrace large contiguous areas far beyond the original city limits. In the case of the Boston Edison Co., which supplied electricity originally to only one-eighth of a square mile, the area embraced by the circuits of the same company is now 700 square miles. The same principle has been given another application in the bringing together under one manage-

ment of a large number of extraurban central station properties whose areas of service march together.

"The Public Service Co. of New Jersey furnished electricity, gas or electric street railway service, in 1912, to 202 municipalities in the State with a total population of 2,028,947, of which 173 communities with a population of 1,947,199 were supplied with electricity for light, heat, power, etc. It is unquestionably true that in all these places the quality, price and continuity of the service were superior to what could be obtained through a number of small and often struggling local enterprises.

"Equally notable in respect to extent and comprehension of system is the Pacific Gas & Electric Co. of California, which in 1912 was the owner or operator of plants and properties in 30 counties in central California, furnishing electric light and power to 187 communities, besides supplying gas, water, and street railway service in many of these or other places. The area covered was approximately 37,700 square miles, with a population in 1910 of 1,325,000, or about 55 per cent of that of the entire state.

* * *

"The State of Illinois affords another example of what has been done in this respect. The Central Illinois Public Service Co. at the end of 1912 was serving 87 communities which were originally supplied by no fewer than 49 separate generating plants under nearly as many distinct managements. This number had rapidly been reduced by consolidation to eight, which in turn were to be reduced to four, capable of generating all the needed energy. The advantages of such interconnected operation are best illustrated by the example of the Lake County District, Illinois, where this

unified service effected a decrease in production costs from 7.08 cents per kilowatt hour to 2.87 cents per kilowatt hour, a saving of 4.21 cents per unit.

* * *

"*Holding companies*—* * * It is because of results shown in unification of the one kind or other that in such states as New York, where there are some 321 central station plants, it has been contended that the efficiency would be much higher and the cost of service to the public much lower if there were only 40 such plants or even only 10. The distribution of electrical energy from this minimized number is easy of practice under modern methods of power transmission, and not at all necessarily dependent upon hydroelectrical development." (pp. 111, 112, 113)

"*Water Power*—* * * If one feature more than any other could be said to arrest the gaze of the observer in the central station field today, it would be that of the consolidation into one system of numerous small plants in a given territory, requiring the application to ordinary central station operation of the principles and practices that hitherto have applied to pure power-transmission systems. It was the habit, only a few years ago, to think of central stations and of power-transmission systems as things apart. Today, so swift is the march of events and improvements in the field, the two arts are found overlapping, blended, merged and the whole revolution is predicated upon the conservation and utilization of hitherto wasted resources of power, upon the greater economy possible in dealing with existing equipment, and upon cheaper, better service to the public." (P. 122)

The book continues to cite various instances of huge central station plants and long distance transmission. In speaking of the Mississippi River Electrical Development at Keokuk, Iowa, it is said:

"Several transmission lines have been erected, one 110,000-volt line covering the territory along the river as far south as St. Louis, 144 miles from Keokuk; one 66,000-volt line from Meppen to Alton; two 33,000-volt lines, one to Hannibal and one to Quincy; and one 11,000-volt line covering the territory up the river to Burlington. The bulk of the present energy is disposed of in St. Louis, where 60,000 horsepower is contracted for on a 99-year lease." (p. 123)

* * *

"In New England the conspicuous example is the Connecticut River Transmission Co., which, beginning a few years ago with a plant on the river at Vernon, Vt., of 20,000 horsepower, has grown into a large enterprise, reaching through its circuits such cities as Fitchburg, Clinton and Worcester, Mass., and Providence, R. I., with energy developed at a series of plants all capable of feeding into the common transmission network, in which the line pressure runs up to 120,000 volts.

"The Southern Power Co. has long been a leader in electrical power development and transmission, and its work has been instrumental not only in stimulating a great variety of industries in North and South Carolina, but in setting an example to other sections of the country. This Company now has operating voltages of 100,000 and transmits energy to a distance of 210 miles, a range exceeded slightly at probably only one or two other points within the United States and nowhere else in the world." (p. 128)

Speaking of the Ocoee River Plant of the Eastern Tennessee Power Company, it is stated:

> "Energy is transmitted at 66,000 volts over two 3-phase circuits to Cleveland, Tenn., a distance of 13 miles from the plant; and from the switching station in Cleveland, where the lines separate, the energy is carried over single-circuit wood-pole lines 26 miles west to Chattanooga, Tenn., 85 miles northeast to Knoxville, Tenn. and 75 miles south to Rome, Ga." (p. 129)

Even more spectacular developments were made on the Pacific Coast which the book outlines in detail. Opposite page 132 of the book appears a large table giving the long distance transmission lines of the country.

> "*Tower and line construction and installation*—A typical steel-tower installation at high voltage was that put in operation in 1911 for 135,000-volt transmission from AuSable to Flint, Mich., 125 miles away, and also to Battle Creek, 65 miles farther, tying in at various other points to the 44,000-volt network spread out over southern and central Michigan." (p. 134)
>
> * * *
>
> "*Outdoor substations*—The development of outdoor substations has been one of the marked features of the period, associated with long-distance transmission work. The problem of furnishing electricity to isolated communities and consumers has received much attention and is now generally recognized as a serious and important undertaking. * * * The situation, therefore, is improved, as the consolidation and unification of central station systems have resulted in a large mileage of transmission lines passing through the districts

ready and waiting for electrical service. The problem has resolved itself into the building of lines from a large capacity centralized plant to definite points where loads of suitable characteristics to justify the expense can be secured. From these high-tension feeders, branches extend along the way to farms, mills, stone quarries, grain elevators, irrigation projects, railways, pumping installations, dairy farms, canning factories, brick or tile plants, excavating shovels, etc.

"The small generating station supplying a town or village is necessarily at a distinct disadvantage in the generation and distribution of electricity as compared with the larger stations, as the economy is low. This condition is due to the small quantity of power generated, the poor load factor, and the fact that the size of the enterprise does not justify the employment of highclass engineers or operators. The small generating station is therefore being quite generally superseded by a substation, supplied from a high-tension transmission line serving a number of communities. With one or more small towns as a nucleus, the transmission line is built—the first step toward supplying an entire district or even a county from a centralized plant. The supply of power along the main transmission lines has thus become a comparatively simple matter, aided largely by the outdoor substation reducing the investment required and therewith the cost of the current furnished." (p. 135)

* * *

"Electricity in Agriculture.

"*Power, lighting and heating*—The use of electricity on the farm has been pursued and developed with extraordinary rapidity in recent years. The chief reasons are the extension of power-transmission circuits

from central stations in cities, and the establishment and distribution networks in connection with hydro-electric enterprises looking for patronage of every description.

* * *

"Concrete examples of this significant development exemplify what is being done all over the country. At the meeting of the Illinois State Electrical Association in 1911, this subject was brought up, and some most interesting statistics were presented. Mr. E. L. Brown of Elmwood, Ill., described his local system comprising 30 miles of transmission lines connecting 8 small towns and supplying about 50 farms.

* * *

"At Liberty, Ind., the Liberty Light & Power Co. in 1912 furnished electric lighting service from its 32 miles of 13,200-volts and 6,600-volts transmission lines to a number of farmers in the vicinity." (p. 155)

Electrical Utilities in Indiana in 1913 Serving More Than One Community.

SOURCE: The McGraw Electrical Directory, Lighting & Power Edition List of Central Stations in United States, Canada and Mexico, April 1913.

Company	Number of Communities Served At Retail	At Wholesale
Crown Point Electric Co. (T)	2	..
Fort Wayne & Northern Indiana Traction Company (T)	3	7
Indiana & Michigan El. Co. (I) (T)	2	1
Indiana Railways & Lt. Co., (T)	8	1
La Porte El. Co. (T)	2	..
Liberty Lt. & Pr. Co. (I)	3	..
Muncie El. Lt. Co. (T)	6	1
Noblesville Heat, Light & Power Co. (T)	4	1
Northern Indiana Gas & El. Co. (T)	8	..
Northern Indiana Utilities Co. (T)	11	..
Spencer Lt., Pr., Ht. & Water Co. (T)	2	..
Sullivan County El. Co. (T)	4	..
Terre Haute, Indianapolis & Eastern Traction Co. (I) (T)	6	2
United G. & E. Co. (T)	6	..

(I) Also served one or more communities outside of Indiana.

(T) Had transmission lines connecting central stations with distribution systems in two or more communities served.

Company	Number of Communities Served At Retail	At Wholesale
Ashley Electric Light Co.	2	..
Batesville Elec. Lt. & Pr. Co.	1	1
Citizens Heat, Light & Pr. Co.	5	..
Danville Lt., Ht. & Pr. Co.	3	..
Evansville G. & El. Lt. Co.	2	..
Gragg Brothers El. Lt. Plant	2	..
Indiana El. Transmission Co.	3	..
Indiana Public Service Co.	2	..
Indiana Union Traction Co.	..	3
Indiana Utilities Co.	4	..
Indianapolis Lt. & Ht. Co.	3	..
Kehoe Lt. & Pr. Co. (P)	6	..
Madison Lt. & Ry. Co.	3	..
Marion, Bluffton & Eastern Trac. Co.	3	1
Merchants Heat & Light Co.	4	..
Remington El. Co.	2	..
Southern Indiana Pr. Co.	..	2
Syracuse Pr. & Lt. Co.	2	..
Winona El. Lt. & Water Co.	2	..
Winona Interurban Ry. Co.	..	2

(P) Purchased its power at wholesale from Ft. Wayne & Northern Ind. Trac. Co.